

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
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Sacramento, California 95814**

**File No: RH 05045970**

**Date: September 26, 2006**

**INITIAL STATEMENT OF REASONS**

**WORKERS' COMPENSATION DEDUCTIBLES AND LOSS RESERVES**

***INTRODUCTION***

California Insurance Commissioner John Garamendi (hereinafter "Commissioner") proposes to add Article 9.8, sections 2509.80 through 2509.84 entitled "Workers' Compensation Deductibles and Loss Reserves" to the California Code of Regulations, Title 10, Chapter 5, Subchapter 3. The proposed regulations establish those forms of collateral or security that a workers' compensation insurer may designate to secure the deductible amount of any policy of workers' compensation insurance and to establish the basis for reserves and recognition of receivables for workers' compensation insurers writing workers' compensation deductible policies.

***SPECIFIC PURPOSE AND REASONABLE NECESSITY***

Sections 2509.80 and 2509.81 describe the authority and purpose of these proposed regulations and provide definitions for the most frequently used words. Section 2509.82 describes the deposits and forms of security that are acceptable to the commissioner for workers' compensation insurers to obtain and receive credit for against deposits required to be posted pursuant to Insurance Code section 11691. Section 2509.83 sets forth the method by which workers' compensation insurers shall establish loss and loss adjustment expense reserves for workers' compensation deductible policy losses and claims and that method includes calculating the earned premium as if there were no deductible since workers' compensation insurers are responsible for payment of all losses and can only obtain reimbursement from insured employers for the deductible. Section 2509.84 sets forth that the commissioner may examine and audit workers' compensation insurers to determine compliance with the requirements of these regulations.

These sections are reasonably necessary to provide workers' compensation insurers with clear, detailed information and instructions regarding the forms of collateral that may be obtained from insured employers for the deductible under a workers' compensation deductible policy, the credit against required deposits for workers' compensation losses a workers' compensation insurer may obtain for such collateral, and how to calculate the reserves for workers' compensation deductible policy losses and claims based upon premium for a workers' compensation policy without a deductible since the workers' compensation insurer is responsible for the entire loss and only may obtain reimbursement from the insured employer for the deductible amounts. The specific purpose of each regulation and the rationale for the Insurance Commissioner's determination that each regulation is reasonably necessary to carry out the purpose for which it is

proposed are set forth below. Implementation of these regulations is necessary for the efficient administration and enforcement of the Insurance Code.

**§2509.80. Authority and purpose**

This section sets forth the authority under which these regulations are promulgated. It specifies the purpose of the regulations is to establish, as directed by legislation, those forms of collateral or security that an insurer may designate to secure the deductible amount of any policy of workers' compensation and to establish the basis for reserves and recognition of receivables for insurers writing worker's compensation deductible policies. This section notes that workers' compensation insurers are obligated under section the Insurance Code to pay all claims in full under such deductible policies and that the deductible establishes only a legal obligation of reimbursement by the insured employer to the workers' compensation insurer. In addition, this section notes the reserves and required deposits shall be established for workers' compensation deductible policies as if they were similar workers' compensation policies without deductibles and allows credit against those required deposits for the collateral obtained from the insured employer.

**§2509.81. Definitions**

This section provides definitions to words and terms used throughout the regulations. Although many of the words and terms defined have a generally understood meaning in the insurance industry, definitions of certain words and terms are included to avoid any ambiguity or uncertainty in the application of the regulations. Certain of the definitions are used to encompass concepts that may not be readily apparent from the word or term used. These definitions are discussed below. These definitions are reasonably necessary to inform affected persons of the specific applicability and specific meaning of various requirements.

"Assets held in trust" is defined in this section and means assets in the form of cash; investments as authorized as general investments under Article 3 (commencing with Section 1170) of Chapter 2 of Part2 of Division 1 of the Insurance Code; readily marketable securities acceptable to the insurance commissioner that are listed on U.S. national or principal regional securities exchanges; or clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified United States financial institution, as defined in subdivision (a) of Section 922.7 of the Insurance Code, in the name of the workers' compensation insurer and held in this state in trust in a form acceptable to the Commissioner at a qualified depository with the workers' compensation insurer as trustee and the California Insurance Commissioner as an additional beneficiary. The definition is reasonably necessary to clarify those assets that will be acceptable for such collateral received by insurers for workers' compensation deductible policies. The definition includes those assets which are generally accepted by the Commissioner pursuant to Insurance Code section 11691 as deposits to pay for compensation losses and claims and also include letters of credit that meet the specified standards and that are held in this state in trust at a qualified depository.

"Collateral" or "security" is defined in this section and means the property or assets given to secure the obligation of an insured employer for reimbursement or payment of the deductible amount, or amount agreed to be paid of a workers' compensation claim, under the workers'

compensation deductible policy. The definition is reasonably necessary to clarify these terms since these terms can take on different meanings.

“Qualified depository” is defined in this section and means a qualified depository as set forth in subparagraph (2) of subdivision (a) of Insurance Code section 1104.9 that is located in this state. This definition uses the definition contained in the Insurance Code but limits it to only those qualified depositories located in this state where certain assets held in trust will be maintained for purposes of obtaining those assets to pay compensation for California workers. The definition is reasonable necessary to make certain the term used and to clarify that it is similar to the term used in the Insurance Code.

“Worker’s compensation deductible policy” is defined in this section and means one, or any combination of more than one, policies, endorsements, contracts, or security agreements in which the employer who is insured for its workers’ compensation liability has agreed to reimburse the workers’ compensation insurer for losses incurred up to the deductible amount elected or payments made up to a specified dollar amount in connection with the workers’ compensation insurance coverage or agreed with the workers’ compensation insurer to either pre-fund the initial portion, or some amount thereof, of any potential workers’ compensation claim, or the potential expenses related to any claim, under the policy up to a specified dollar amount. The definition is reasonably necessary to make clear what workers’ compensation deductible policies are since they can take on various forms and can be written in different ways for determining deductible types and how those deductible amounts are calculated.

“Workers’ compensation insurer” is defined in this section and means any insurer that is or is required to be admitted to transact workers’ compensation insurance in the State of California including the State Compensation Insurance Fund. This definition is reasonably necessary to clarify that these regulations apply to any insurer and the State Compensation Insurance Fund that handles California workers’ compensation coverage. California Labor Code section 3700 requires that only duly authorized insurers may write workers’ compensation insurance for California employers.

#### **2509.82. Deposits and forms of security that workers’ compensation insurers may use to secure deductible policies**

This section requires workers’ compensation insurers, except the State Compensation Insurance Fund, to calculate deposit requirements for workers’ compensation deductible policies on the same basis as policies providing first dollar coverage and pursuant to the further requirements of the proposed article. This section also allows as credit against the deposit requirements of Insurance Code section 11691 the amount of collateral obtained as assets held in trust on workers’ compensation deductible policies. This section is reasonably necessary to inform insurers of the method to calculate deposit requirements since workers’ compensation insurers are obligated to pay all losses and claims in full under a workers’ compensation deductible policy and treat the deductible only as an advancement of funds by the insurer for which the insurer has a right of reimbursement. There exists the potential for insurers not to be able to obtain deductible amounts from insured employers for which the insurer is obligated to pay. However, this section allows for a credit against the deposit requirement of section 11691 if the

insurer has obtained collateral to secure the obligation of the employed insurer to reimburse the insurer. The credit given will be in the amount of the collateral received. Insurers may obtain such security pursuant to Insurance Code section 11735(e)(3).

The State Compensation Insurance Fund has been excluded from this section since it is excluded from deposit requirements under Insurance Code section 11691, to which this regulation section applies.

**2509.83. Reserve requirements for workers' compensation deductible policies.**

This section requires workers' compensation insurers to establish loss and loss adjustment expense reserves for workers' compensation policy losses and claims on the same basis as the insurer would calculate such reserves on policies for first dollar coverage and according to the requirements of the proposed article when using premium to calculate reserves pursuant to section 923.5 and Article 1 (commencing with section 11550) of Chapter 1 of Part 3 of Division 2 of the Insurance Code. In addition, for purposes of establishing loss and loss adjustment expense reserves for the three most recent years of coverages for section 923.5 and Article 1 (commencing with section 11550) of Chapter 1 of Part 3 of Division 2 of the Insurance Code, earned premium is established using the estimated annual premium for full coverage without a deductible. Finally, the premium for workers' compensation deductible policies is required to be adjusted to reflect workers' compensation audit premiums, which are subject to the commissioner's examination and audit. This section is reasonably necessary to inform insurers of the requirement that reserves must be based upon the risk undertaken by the insurer despite their being a deductible. When loss and loss adjustment expense reserves are based upon premium, those premiums must be calculated upon the entire risk that the insurer is undertaking and is obligated to pay rather than a premium, which may be discounted, under a workers' compensation deductible policy. Workers' compensation insurers are obligated to pay all losses and claims in full under a workers' compensation deductible policy and treat the deductible only as an advancement of funds by the insurer for which the insurer has a right of reimbursement pursuant to Insurance Code section 11735(e). There exists the potential for insurers not to be able to obtain deductible amounts from insured employers for which the insurer is obligated to pay. Insurer audit premiums, which are immediately booked after being adjusted, must be reflected in the premium calculation, and insurers are informed by this section that such change are subject to change due to the commissioner's examinations and audits.

**2509.84. Commissioner's right to examine and audit collateral and reserves for workers' compensation deductible policies**

This section sets forth the power of the commissioner to examine and audit the assets held in trust and the loss and loss adjustment expense reserves of the insurer related to workers' compensation deductible policies to verify compliance with this article. This section is reasonably necessary to inform the affected persons of the commissioner's powers under the Insurance Code, including section 730, to examine insurers to determine adherence to the requirements under the Insurance Code.

### ***SPECIFIC TECHNOLOGIES OR EQUIPMENT***

Adoption of these regulations will not mandate the use of specific technologies or equipment.

### ***IDENTIFICATION OF STUDIES, REPORTS, DOCUMENTS***

The Department did not consider any studies, reports or documents in promulgating these regulations.

### ***REASONABLE ALTERNATIVES***

The Commissioner has determined that no reasonable alternative exists to carry out the purposes for which the regulations are proposed. These regulations were mandated by the legislature as a method of accounting for collateral and establishing reserves for workers' compensation deductible policies.

### ***ECONOMIC IMPACT ON SMALL BUSINESS***

The Commissioner has determined that the proposed regulations will not affect small business as these regulations set forth requirements for insurance companies that insure for workers' compensation to take credit against deposits for specified collateral obtained for deductible policies and to establish loss reserves for losses incurred under deductible policies. Pursuant to Government Code section 11342.610, subdivision (b), paragraph (2), workers' compensation insurers are not small businesses. The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business.

### ***ASSESSMENT OF ADVERSE ECONOMIC IMPACT ON BUSINESS***

The Commissioner has determined that there is no adverse economic impact on business as a result of these regulations. These regulations will require workers' compensation insurers to make deposits as they are currently required but specifies that calculation of deposits, and the reserves that those deposits are based upon, for workers' compensation deductible policies are to be done by the same method as first dollar coverage workers' compensation policies. These deposits are obtained to provide some level of protection for the payment of compensation to injured workers in the case of insolvency by the workers' compensation insurer. Workers' compensation insurers may obtain collateral from insured employers to ensure payment of the deductible, and these regulations allow a reduction of the required deposit by the amount of the collateral.

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently operating in the state. The Commissioner estimates that the proposed regulations will not have any impact or significant effect in these areas.

### ***PRE-NOTICE PUBLIC DISCUSSIONS***

No pre-notice public discussions were conducted in promulgation of these regulations.